



San Diego City Attorney **MICHAEL J. AGUIRRE**

NEWS RELEASE

FOR IMMEDIATE RELEASE: July 27, 2006

Contact: Maria Velasquez, Communications Director (619) 235-5725 mvelasquez@sandiego.gov

CITY FILES LAWSUIT SEEKING \$10 MILLION FROM FORMER OUTSIDE CONSULTANT VINSON & ELKINS

Complaint Includes Professional Negligence

San Diego, CA: The City Attorney's Office filed in Superior Court this morning a lawsuit against the law firm of Vinson & Elkins, for Breach of Contract; Breach of Fiduciary Duties; and Professional Negligence. The City Attorney's Office is seeking over \$10 million in general damages, punitive damages and the costs of the lawsuit. The law firm is one of several outside consultants hired since 2002 to investigate the pension fund crisis. The City Council approved the filing of this lawsuit.

"On behalf of the taxpayers and the City Council, the City is asking for a **REFUND** for incompetent work performed," said City Attorney Michael Aguirre. "We will no longer tolerate exploitation by outside consultants who take advantage of a city when it's most vulnerable. We will recover this money and hold these people accountable."

Vinson & Elkins charged the City \$6.2 million to produce an "objective" report for the City's 2003 audit which is still being conducted by KPMG, an outside audit firm. In addition, Vinson & Elkins was to represent the City in the U.S. Securities & Exchange Commission's investigation into the City's financial disclosure practices and our pension system.

According to Aguirre, it failed in both endeavors, despite repeated warnings and admonishments, and knowingly breached its fiduciary duty to report wrongdoing to the City Council and Mayor.

"This failure caused the City to hire outside risk management firm Kroll Inc., which has, to this date, charged the City over \$20 million and has not yet completed its report. The KPMG audits of 2003, 2004, and 2005 are incomplete," said Aguirre.

In August 2005, Vinson & Elkins' contract was terminated by the City Council, after billing the City \$6.2 million and failing to meet professional standards in its investigative report and in its representation of the City before the SEC.

The lawsuit is being filed on a contingency basis on behalf of the City by the law firms of Stanford and Associates and Bryan C. Vess APC which have advanced the costs of the lawsuit.

(MORE)

Background:

In September of 2003, the City was made aware of disclosure errors and omissions by the San Diego City Employees Retirement System (SDERS) Board, which led to the admission of errors in the City's 2002 audit, or 2002 Comprehensive Annual Financial Report (CAFR) which is submitted to the U.S. Securities and Exchange Commission (SEC) for bond ratings. As a result, Vinson & Elkins' original contract to review Web pages was amended in December 2003 for additional consultations and legal services and "other disclosure related issues" as-needed for two additional years, costing "no more than \$27,000."

In January, 2004 the SEC informed the City of San Diego that it would be investigating the financial disclosure practices of the City. Vinson & Elkins was retained by the City of San Diego for an additional \$150,000 to write an "objective" report that would satisfy the SEC, and the City's outside auditor, KPMG, who was holding off the 2003 audit until an investigation into the disclosure practices could be completed.

While waiting for the Vinson & Elkins report, KPMG, the City Attorney and, eventually then-City Manager Lamont Ewell communicated regularly with V&E to remind them that specific information had to be included to satisfy the American Institute of Certified Public Accountants requirements and to complete the objective report in a timely manner.

In April 2004, the City Council appropriated an additional \$350,000 to complete the report and represent the City before the SEC. The next month, the City Council appropriated an additional \$800,000 for Vinson & Elkins' services. By the end of August 2004, the report was not completed, and the City Council appropriated an additional \$700,000 to V&E.

In September 2004, the Vinson & Elkins report was finally issued, titled, "Report on Investigation; The City of San Diego, California's Disclosure Obligation to Fund the San Diego City Employees' Retirement System and Related Disclosure Practices." The report acknowledged wrongdoing but not criminal intent, but did not base that finding on sufficient evidence. KPMG found it beneath professional auditing standards, but Vinson & Elkins promised to finish the investigation and provide a second report. The City Manager approved an additional payment of \$250,000 to Vinson & Elkins and directed them to report directly to the Mayor with the investigation results. In November, Vinson & Elkins asked for an additional \$350,000 to represent the City in the SEC investigation.

In 2005, the SEC advised the City that Vinson & Elkins' representation was flawed and not reliable. At this point, neither KPMG nor the SEC found Vinson & Elkins' work acceptable. The newly-elected City Attorney had issued several Interim Reports that directly alleged illegal activity. The City was forced to hire Kroll Inc. to sort out the discrepancies between Vinson & Elkins' analysis and the City Attorney's reports. Vinson & Elkins issued its second report directly to Kroll, bypassing the City Council, Mayor and City Attorney. This second report was also found to be beneath the requirements of a professional audit. Vinson & Elkins' contract was terminated by the City, after \$6.2 million in payments.

(MORE)

The lawsuit alleges that the firm failed to meet professional standards in both its investigative report and its representation of the City before the SEC. This failure caused the City to hire Kroll Inc., which has, to this date, charged the City over \$20 million and has not yet completed its report. The KPMG audits of 2003, 2004, and 2005 are incomplete.

#